Minutes of the Meeting of the Treasury Borrowing Advisory Committee of the Securities Industry and Financial Markets Association October 29, 2019

October 30, 2019

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The Committee convened in a closed session at the Department of the Treasury at 9:00 a.m. All members were present. Principal Deputy Assistant Secretary for Financial Markets Kipp Kranbuhl, Deputy Assistant Secretary for Federal Finance Brian Smith, Director of the Office of Debt Management Fred Pietrangeli, and Deputy Director of the Office of Debt Management Nick Steele welcomed the Committee. Other members of Treasury staff present were Ayeh Bandeh-Ahmadi, Chris Cameron, Barbara Charles, Dave Chung, Mary Jones, Tom Katzenbach, Tim Khang, Brandon Taylor, Tom Vannoy, and Brad Wendt. Federal Reserve Bank of New York staff members Oliver Giannotti, Susan McLaughlin, Kathryn Chen, and Kyle Lee were also present.

Director Pietrangeli began by providing an overview of the fiscal situation. Pietrangeli noted that FY2019 receipts were $133 billion (4 percent) higher than FY2018. Withheld income and FICA taxes rose by $78 billion, driven by growth in wages and employment. Customs duties rose by $30 billion due to new tariffs. Non-withheld income and SECA taxes rose by $10 billion, and net corporate taxes were $26 billion higher due to both higher gross corporate taxes and lower corporate refunds. Individual refunds were also lower by $24 billion. Gains were partially offset by an $18 billion decrease in Federal Reserve earnings caused primarily by paying higher short-term interest rates to depository institutions.

Total outlays in FY2019 were $291 billion (7 percent) higher than in FY2018. Treasury outlays were $60 billion higher primarily due to increased interest on the public debt. Other notable increases include $58 billion for increased Social Security enrollment and benefit payments, $50 billion for higher defense spending, and $64 billion for increases in Medicare and Medicaid expenditures. Furthermore, due to differences in subsidy re-estimates, education expenditures increased by $41 billion while Housing & Urban Development outlays were down by $25 billion.

Pietrangeli also noted that net issuance of State and Local Government Securities was up $6 billion in the last quarter, reflecting a resumption of issuance after the debt limit was suspended, as well as a reduction in interest rates encouraging municipalities to refinance.

Turning to financing, Pietrangeli reviewed the most recent annual net marketable borrowing estimates from the Office of Management and Budget, the Congressional Budget Office, and the primary dealers. He noted that the various projections of both deficits and net marketable borrowing needs (which includes estimates for off-budget items such as changes in the cash balance and funding student loans) are around $1 trillion.

Pietrangeli next discussed the financing gap, which is the difference between projected borrowing needs and net issuance assuming current auction sizes remain constant. Without taking into account potential Federal Reserve purchases, there is a slight funding gap in FY2020 that then widens starting in FY2021.

However, when estimates of projected Federal Reserve purchases of Treasury securities are included, the expected funding gap is addressed in FY2020 and reduced in subsequent years. It was noted that the potential effects of Federal Reserve's balance sheet policies on the amount of net issuance in the coming years were estimated based on public announcements. Pietrangeli noted that Treasury will continue to evaluate public communications from the Federal Reserve when considering issuance decisions.

Deputy Director Steele then provided a brief update on the inaugural auction of the October original issue 5-year Treasury Inflation-Protected Security (TIPS). The October 5-year TIPS for the first time provides a maturity in the fourth calendar quarter, allowing for more effective pricing of seasonality. Steele noted that the recent auction was very well received, with a high bid-to-cover ratio and strong end-user demand.

Next, Debt Manager Katzenbach briefly outlined the effect of Federal Reserve purchases on Treasury's net privately-held marketable borrowing. He explained that the Federal Reserve's secondary market purchases of Treasury securities do not directly change net privately-held marketable borrowing needs. However, all else equal, when those Federal Reserve holdings mature, rollovers will increase the amount of cash raised for a given privately-held auction size by increasing the System Open Market Account (SOMA) "add-on" amount. Katzenbach added that if Treasury does not lower the privately-held gross issuance by the amount of the SOMA purchase, the net cash raised in a given auction would increase by the incremental amount of the SOMA "add-on." If, on the other hand, Treasury chooses to achieve the same net privately-held marketable borrowing figure, it can reduce the privately-held gross issuance by the equivalent amount.

Steele then gave a summary of the primary dealer feedback regarding the potential introduction of a 20-year bond. Steele emphasized that Treasury is considering a range of potential new products that includes a 20-year bond, an ultra-long bond such as a 50-year, and a floating rate note linked to the Secured Overnight Financing Rate. Overall, primary dealers viewed the potential introduction of a new 20-year bond favorably in the context of increased financing needs beginning in FY2021, as they expect the security could fit into Treasury's regular and predictable issuance paradigm. Primary dealers also commented that there is already a liquid futures contract in that sector of the curve.

Estimates varied for the size and pricing but the mean estimate was for around $130 billion in annual issuance for the first year, with the first and third quartile range of around $70 to $160 billion (median $100 billion). Most primary dealers believe that a 20-year bond would yield slightly higher than the mid-point between the 10-year note and the 30-year bond, which would also be slightly higher than existing off-the-run bonds in the sector. It was noted that over time the 20-year bond could richen as benchmark liquidity developed. Demand is expected from liability driven investors, though some primary dealers suggested that Treasury consider modestly decreasing issuance sizes of the 10-year and 30-year in order to smooth the introduction of a 20-year bond.

Deputy Assistant Secretary Smith then summarized primary dealer projections for the Federal Reserve's purchases of Treasury securities. Some primary dealers expect the Federal Reserve to gradually reduce the size of purchases or shift the composition of purchases to include short-dated nominal coupons in FY2020, while others expect the size of monthly T-bill purchases to remain at $60 billion through Q2 CY2020. The consensus from primary dealers is that Treasury is well funded for most of FY2020 and does not need to change coupon auction sizes this quarter. Smith acknowledged the importance of continuing to monitor the Federal Reserve's balance sheet policy and the potential implications for Treasury financing plans.

Smith then turned to the feedback on primary dealer net positions of Treasury securities. Explanations from the primary dealers included larger Treasury auction sizes, client flows, hedging as part of facilitating client derivatives trades, and primary dealer investment strategies. Smith noted that feedback suggests the inventories are not evenly distributed across primary dealers and thus have been driven in part by idiosyncratic considerations at particular primary dealers.

Katzenbach then discussed the auction calendar for the upcoming December holidays, commenting that there are several auctions during the week of Christmas and that auctions will need to be scheduled with consideration for the Christmas holiday on a Wednesday. Katzenbach shared one option for the Committee to consider. The Committee discussed a few possible alternatives but was broadly supportive of the option presented.

The Committee then turned to a discussion around Treasury's financing for the upcoming quarter. The Committee agreed that given the funding outlook, no changes are needed at this time to nominal coupon auction sizes. The Committee then discussed expectations for bills outstanding in light of the Federal Reserve's decision to purchase bills to manage reserves and the anticipated seasonal change in bill issuance. With no changes to nominal coupon auctions, the amount of privately-held bills is expected to decline over the next several months. The Committee discussed the potential implications of lower privately-held bills outstanding and unanimously recommended that Treasury should not decrease nominal coupon auctions in order to increase bill issuance at this time. The Committee cited several factors for this recommendation, including uncertainty regarding the Federal Reserve's bill purchases, Treasury's regular and predictable approach, and the higher financing needs starting in FY2021, which will likely require increases in nominal coupon auction sizes. As part of this discussion, the Committee briefly discussed an illustrative financing schedule that demonstrated the extraordinary cuts to short coupon auction sizes that would be necessary in order to maintain the supply of privately held bills around current levels. The Committee agreed that such a dramatic cut in coupon sizes was not practical or desirable, and served only to reinforce their recommendation of no change to nominal coupon auction sizes. Finally, the Committee agreed that further consideration of its prior recommendation regarding the appropriate share of Treasury bills was warranted in a future meeting.

The Committee also briefly discussed TIPS issuance and agreed that auction sizes should remain at current levels, which is expected to increase overall TIPS issuance for CY2019 by $21 billion, in line with prior expectations.

The Committee then reviewed a presentation on the potential introduction of a 20-year Treasury bond. The presenting member suggested that Treasury should consider adding a 20-year bond to its current auction schedule in light of projected increases in borrowing needs in the coming years and the potential that the security could attract additional demand from corporate pensions and insurance companies. Issuance at this maturity could relieve pressure from 10-year notes and 30-year bonds as auction sizes increase in future years and could become a new liquid pricing point for 20-year corporate issuance. Based on analysis that showed the 20-year sector as rich to fair value estimates, the presenting member reasoned there may be unmet demand.

However, the presenting member also discussed the history of 20-year issuance in the 1980s and the hump that developed in the curve during that period, inverting the yield between the 20-year and 30-year bond at the time. The Committee discussed the potential convexity considerations regarding 20-year bond issuance but did not reach a consensus about how they should be valued. While new issuance could initially price with a slight concession to fair value, the presenting member maintained that the 20-year could richen over time as the point becomes established, but could still appear costly compared to 10- and 30-year maturities on a duration weighted basis.

Given current annual auction sizes and the proportion of long-duration debt issued by other major sovereign issuers, the presenting member suggested an initial annual issuance size of around $140 billion or 22 percent of 10-year or greater maturity issuance, which could grow over time. A quarterly new issue maturing on the 15th of the month with auctions occurring in the third week of the month, and with an end-of-month settlement, was also discussed. After weighing the pros and cons of a new 20-year bond compared to increased issuance of 10- and 30-year maturities to meet future financing needs, the committee agreed that a new 20-year bond was worth further consideration.

The Committee adjourned at 12:00 p.m. for lunch.

The Committee reconvened at the Department of the Treasury at 4:30 p.m. All Committee members were present. The Chair summarized key elements of the Committee report for Deputy Secretary Muzinich, and followed with a brief discussion of recent market developments.

The Committee adjourned at 5:15 p.m.

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Brian Smith

Deputy Assistant Secretary for Federal Finance

United States Department of the Treasury

October 29, 2019

Certified by:

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Elizabeth Hammack, Chair

Treasury Borrowing Advisory Committee

Of The Securities Industry and Financial Markets Association

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TREASURY BORROWING ADVISORY COMMITTEE QUARTERLY MEETING

COMMITTEE CHARGE – OCTOBER 29, 2019

Fiscal Outlook

Taking into consideration Treasury's short, intermediate, and long-term financing requirements, as well as the variability in financing needs from quarter to quarter, what changes to Treasury's coupon auctions do you recommend at this time, if any? Please also provide feedback on market expectations for Treasury issuance, the effects of current SOMA reinvestment policy, the evolution of Treasury holdings by investor class, as well as auction calendar construction.

Potential 20-Year Bond Issuance

Over the past several years, TBAC and market participants have proposed that Treasury consider issuing a 20-year nominal coupon bond. Treasury would like the Committee to comment on the current expected demand and pricing for a 20-year Treasury bond. Additionally, how should Treasury consider incorporating such a security into its issuance calendar?

Financing this Quarter

We would like the Committee's advice on the following:

- The composition of Treasury notes and bonds to refund approximately $60.5 billion of privately-held notes maturing on November 15, 2019.
- The composition of Treasury marketable financing for the remainder of the October-December 2019 quarter, including cash management bills.
- The composition of Treasury marketable financing for the January-March 2020 quarter, including cash management bills.